

NationsBank Corporation
Legal Department
NationsBank Corporate Center
100 North Tryon Street, NC1-007-20-01
Charlotte, NC 28255

March 26, 1997

BY OVERNIGHT DELIVERY

Mr. Steven J. Weiss
Deputy Comptroller
Bank Organization & Structure
Office of the Comptroller
of the Currency
250 E Street, S.W.
Washington, D.C. 20219

Re: Application for Permission to Engage in Real Estate Lease Financing
Activities Through an Operating Subsidiary

Dear Mr. Weiss:

Pursuant to 12 C.F.R. § 5.34, NationsBank, National Association (“NationsBank, N.A.”), Charter Number 14448, requests approval to engage in real estate lease financing activities through a newly established operating subsidiary (the “Subsidiary”). NationsBank, N.A., an “eligible bank” as defined in Section 5.3(g), is filing this application pursuant to Sections 5.34(e)(1) and 5.34(f) for permission to engage in activities that are part of or incidental to the business of banking, but are different from those permissible for a national bank.

I. Description of Proposed Activities

Under the proposal, the Subsidiary will engage in real estate lease financing transactions on a nationwide basis, subject to certain limitations designed to minimize the risk to the Subsidiary and NationsBank, N.A. In particular, the Subsidiary’s real estate lease financing transactions will be on a “nonoperating” basis, and will be for an initial term of at least 90 days. The real estate leases will be “full payout” leases, such that, at the inception of

the lease, the effect of the transaction will yield a return that will compensate the Subsidiary for not less than the Subsidiary's full investment in the real property plus the estimated total cost of financing the property over the term of the lease from rental payments, estimated tax benefits, and the estimated residual value of the property at the expiration of the initial term. For purposes of determining whether a given lease is a "full payout" lease, the estimated residual value of the property will not exceed 25% of the acquisition cost of the property to the Subsidiary.¹ As a result, the real estate lease financing transactions will be the functional equivalent of mortgage loans made by the Subsidiary.

The Subsidiary will acquire real property only in connection with a proposed leasing transaction. Thus, the Subsidiary will not acquire real property in anticipation of leasing the property at a later date. If upon termination or expiration of the lease the lessee does not acquire the real property, the Subsidiary either will enter into a new lease agreement with the lessee or with a third party or will reclassify the property as OREO and dispose of the real property in accordance with OCC OREO guidelines.

II. Proposed Organization and Structure

The Subsidiary will be organized as a corporation or a limited liability company, with NationsBank, N.A. as its sole shareholder. Accordingly, NationsBank, N.A. will be insulated from unlimited liability for the actions of the Subsidiary. To further insulate NationsBank, N.A. from liability, the Subsidiary will comply with the corporate safeguard requirements set forth in 12 C.F.R. § 5.34(f), in particular:

- The Subsidiary will be physically separate and distinct in its operations from NationsBank, N.A.;

¹ These limitations are substantially similar to those imposed by the Board of Governors of the Federal Reserve System on nonbanks under its new real estate leasing regulations, effective April 21, 1997. See Final Rule, Bank Holding Companies and Change in Bank Control (Regulation Y), 62 FED. REG. 9290 (Feb. 28, 1997). These requirements are also substantially similar to the requirements imposed by the OCC on personal property leases under its regulations set forth at 12 C.F.R. Part 23.

- The Subsidiary will be held out as separate and distinct from NationsBank, N.A. in its written material and direct contact with third parties, and all written marketing materials will clearly state that (i) the Subsidiary is a separate entity from NationsBank, N.A. and (ii) the obligations of the Subsidiary are not obligations of NationsBank, N.A.;
- The Subsidiary's name will be different from that of NationsBank, N.A., and to the extent that the names are similar, NationsBank, N.A. and the Subsidiary will take steps to avoid customer confusion;
- The Subsidiary will be adequately capitalized under leasing industry standards and will maintain capital adequate to cover reasonably expected losses and expenses;
- The Subsidiary will maintain separate accounting and corporate records,
- The Subsidiary will conduct its operations pursuant to independent policies and procedures that are also intended to inform customers that the Subsidiary is an organization separate from NationsBank, N.A.;
- All contracts between the Subsidiary and NationsBank, N.A. (or any of its affiliates) will be on terms and conditions substantially comparable to those available to or from independent entities;
- The Subsidiary will observe appropriate separate corporate formalities, such as separate board of directors' meetings;
- The Subsidiary will maintain a board of directors at least one-third of whom will not be directors of NationsBank, N.A. and will have relevant expertise capable of overseeing the Subsidiary's activities;
- The Subsidiary and NationsBank, N.A. will have internal controls adequate to manage the financial and operational risks associated with the Subsidiary;
- NationsBank, N.A.'s capital and total assets will be reduced by an amount equal to the bank's equity investment in the Subsidiary, and the

Subsidiary's assets and liabilities will not be consolidated with those of the bank²;

- The standards of Sections 23A and 23B of the Federal Reserve Act will apply to, and be enforced and applied by the OCC with respect to, transactions between the Subsidiary and NationsBank, N.A.; and
- NationsBank, N.A. will remain an "eligible bank" as defined in 12 C.F.R. § 5.33(g) (after taking into consideration the capital deduction discussed above), and if NationsBank, N.A. ceases to be well capitalized for two consecutive quarters, NationsBank, N.A. will submit an acceptable plan to become well capitalized or will divest or otherwise terminate the activities of the Subsidiary.

At this time, NationsBank, N.A. anticipates that the Subsidiary will operate from offices in Charlotte, North Carolina and/or Atlanta, Georgia. The Subsidiary anticipates engaging in real estate lease financing transactions involving property located throughout the United States. Following the establishment of the Subsidiary, the Subsidiary's ultimate parent corporation, NationsBank Corporation, may transfer to the Subsidiary any existing interests in real estate lease financing transactions held by its other subsidiaries, subject to the limitations of Sections 23A and 23B.

III. Permissibility of the Proposed Activities

The OCC construes real estate lease financing to be part of the business of banking or incidental thereto, and has permitted national banks to own real estate for the sole purpose of engaging in such lease financing transactions, albeit in certain limited circumstances. For example, the OCC has long permitted national banks to purchase or construct a municipal facility and, as holder of legal title, to lease the facility to the municipality, provided the municipality has agreed to acquire the facility upon the termination of the lease.³ Also, the OCC has recently stated that it would permit national

² NationsBank, N.A. will reduce its capital and total assets based on the actual amount of capital and assets of the Subsidiary as measured at the end of each calendar quarter

³ See 12 C.F.R. § 7.1000(d)(1) (as amended by Final Rule, OCC Interpretive Rulings, 61 FED. REG. 4849 (Feb. 9, 1996); see also Notice of Proposed Rulemaking, OCC Interpretive Rulings, 60 FED. REG. 11,924, 11,925 (Mar. 3, 1995) (discussing the rationale for a national bank's municipal lease financing authority).

banks, on a case-by-case basis, to acquire an interest in and lease real property where the real property is a component of a personal property lease financing transaction permitted under Part 24 of the OCC's regulations.⁴ In creating both exceptions, the OCC has recognized that real estate lease financing is the functional equivalent of lending and is part of the business of banking, or incidental thereto, and therefore the activity is authorized to national banks and their operating subsidiaries under the incidental powers clause of Section 24 (Seventh).

Despite the foregoing, the OCC has not permitted national banks to engage in real estate lease financing beyond these limited circumstances, due to the general prohibition on a national bank's ownership of real estate set forth in 12 U.S.C. § 29. That Section provides in pertinent part:

A national banking association may purchase, hold, and convey real estate for the following purposes, and no others:

First. Such as shall be necessary for its accommodation in the transaction of its business.

Second. Such as shall be mortgaged to it in good faith by way of security for debts previously contracted.

Third. Such as shall be conveyed to it in satisfaction of debts previously contracted in the course of its dealings.

Fourth. Such as its shall purchase at sales under judgments, decrees, or mortgages held by the association, or shall purchase to secure debts due it.

But no such association shall hold the possession of any real estate under mortgage, or the title and possession of any real estate purchased to secure any debts due it, for a longer period than five years except as otherwise provided in this section.⁵

⁴ See Final Rule, Leasing, 61 FED. REG. 66,554, 66,556 (Dec. 18, 1996).

⁵ 12 U.S.C. § 29.

The object of Section 29's general bar on real estate ownership by national banks was threefold: (i) "to keep the capital of the banks flowing in the daily channels of commerce" (i.e., to prevent banks from diverting their financial resources from other, more valuable uses, such as commercial lending); (ii) to prevent banks from engaging in "hazardous real estate speculation"; and (iii) to prevent banks from accumulating large amounts of real estate to hold in perpetuity.⁶ Section 29 applies by its terms only to the national bank and does not expressly apply to subsidiaries of the national bank.

In circumstances such as these -- in which an activity deemed to be part of the business of banking, or incidental thereto, is prohibited to the national bank by collateral statutory authority (such as Section 29) -- the OCC has recently indicated that the activity may be conducted in the national bank's operating subsidiary, subject to the OCC's comprehensive review and resolution of any legal, policy, or supervisory concerns regarding the proposed activity.⁷ In reviewing the proposal from a legal and policy perspective, the OCC

will consider and weigh (1) the form and specificity of the restriction applicable to the parent bank; (2) why the restriction applies to the parent bank; and (3) whether it would frustrate the purpose underlying the restriction on the parent bank to permit a subsidiary of the bank to engage in the particular activity.⁸

With respect to supervisory concerns, the OCC

will take into account safety and soundness implications of the activity, the regulatory safeguards that apply to the operating

⁶ See *Union Nat'l Bank v. Matthews*, 98 U.S. 621 (1879); see also OCC Interp. Ltr. No. 717 (Mar. 22, 1996).

⁷ See Final Rule, Rules, Policies, and Procedures for Corporate Activities, 61 FED. REG. 60,342, 60,352 (Nov. 27, 1996) (permissible activities for an operating subsidiary "may include activities different from what the parent national bank may conduct directly, if, in the circumstances presented, the reason or rationale for restricting the parent bank's ability to conduct the activity does not apply to the subsidiary, and if the ability of the subsidiary to conduct the activity would not frustrate a congressional purpose of preventing the activity from being undertaken by its parent bank").

⁸ *Id.*

subsidiary and to the activity itself, any conditions that may be imposed in conjunction with an application approval, and any additional undertakings by the bank or the operating subsidiary that address the foregoing factors.⁹

These areas of concern are discussed below.

Legal and Policy Concerns

As mentioned above, from a legal perspective, the proposal is permissible. The proposed activities are part of the business of banking, or incidental thereto, and the proposed activities are not barred to the Subsidiary by Section 29.

As a matter of policy, allowing operating subsidiaries to engage in real estate lease financing is not inconsistent with the policies sought to be furthered by Section 29. First, long term real estate lease financing is the functional equivalent of real estate lending, an activity permissible for a national bank and its operating subsidiaries under 12 U.S.C. § 371.¹⁰ Thus, ownership of real estate for real estate lease financing purposes on a net full payout basis -- where the Subsidiary retains only legal title to the property as lessor and possession and use of the property is vested in the lessee -- is simply a form of an extension of credit and is an appropriate use of NationsBank, N.A.'s financial resources.

Second, the Subsidiary will be structured to minimize any risk to NationsBank, N.A. The Subsidiary will be a separate corporation or limited liability company, effectively shielding NationsBank, N.A. from unlimited liability. Corporate formalities will be observed to minimize the risk that the veil will be pierced. The amount of the Subsidiary's equity interest in real estate lease transactions will be limited to 5% of NationsBank, N.A.'s Tier I capital. The Subsidiary will itself maintain adequate capital in accordance with industry standards, and NationsBank, N.A.'s investment will be deducted from the bank's records for purposes of calculating the bank's

⁹ Id.

¹⁰ Cf. *M & M Leasing Corp. v. Seattle First National Bank*, 563 F.2d 1377 (9th Cir. 1977), cert. denied, 436 F.2d 956 (1978) (personal property leasing on a net full payout basis is the functional equivalent of secured lending and therefore permissible for national banks).

capital ratios. To prevent accumulation of excess real estate, the Subsidiary will acquire real estate only in connection with a proposed real estate lease financing transaction. The full payout requirements and 25 percent limit on residual value will act to limit the Subsidiary's potential loss upon lease termination or expiration that may result from fluctuations in the value of the underlying real estate. These safeguards will ensure that the Subsidiary will not engage in "hazardous real estate speculation" or expose NationsBank, N.A. to undue risk.

Third, given that the Subsidiary will acquire real estate only for the purposes of lease financing and, even so, only in connection with an actual transaction, the Subsidiary will not accumulate large amounts of real estate to be held in perpetuity. During the lease term, the Subsidiary will hold only legal title to the real estate as lessor, while the lessee will have all possessory rights to the property. If the lessee does not acquire the property after termination or expiration of the lease, the Subsidiary either will enter into a new lease agreement with the lessee or with a third party or will reclassify the property as OREO and dispose of the real property in accordance with OCC OREO guidelines. Thus, the Subsidiary will be precluded from accumulating excess real estate or acquiring and holding a given tract in perpetuity.

Supervisory Concerns

Finally, the Subsidiary's proposed real estate lease financing activities should not present any supervisory concerns, given that the OCC has permitted real estate lease financing by national banks themselves, albeit only with respect to a limited class of lessees (i.e., municipalities). In any event, the Subsidiary will comply with the corporate and supervisory safeguards imposed by the OCC under Section 5.34¹¹ as well as the other measures set forth in this letter that will effectively minimize any risk to NationsBank, N.A., its depositors, and the Bank Insurance Fund, and will ensure that the proposed activities are consistent with safe and sound banking practices.

* * * * *

¹¹ 12 C.F.R. § 5.34(f)(2), (f)(3).

Mr. Steven J. Weiss
March 26, 1997
Page 9

Based on the foregoing, the proposed real estate lease financing activities of the Subsidiary are part of the business of banking, or incidental thereto, and therefore are permissible for the Subsidiary. The proposed activities do not otherwise pose any legal, policy, or supervisory concerns, and therefore NationsBank, N.A. should be permitted to establish the Subsidiary and proceed with the proposed activities.

Accompanying this notice is a check payable to the OCC in the amount of \$2,700 for the filing fee for this notice. If you have any questions regarding the above, please call me at (704) 386-7751 or Scott A. Cammarn at (704) 386-1613.

Sincerely,

Gerald P. Hurst
Associate General Counsel

Enclosure

cc: Mr. Ralph E. Sharpe
Mr. Richard T. Erb
Mr. Timothy W. Long
Eric Thompson, Esq.
William Glidden, Esq.
Scott A. Cammarn, Esq.